

117 FERC ¶ 61,014  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;  
Sudeen G. Kelly, Marc Spitzer,  
Philip D. Moeller, and Jon Wellinghoff.

Northwest Pipeline Corporation

Docket No. RP05-379-000

ORDER ON PETITION FOR DECLARATORY ORDER

(Issued October 4, 2006)

1. On June 16, 2005, Northwest Pipeline Corporation (Northwest) filed a petition for declaratory order requesting that the Commission terminate a controversy by declaring that Northwest correctly interprets section 21.3 of its tariff concerning the calculation of certain facilities reimbursement payments. For the reasons discussed below, the Commission grants Northwest's petition in part and denies Northwest's petition in part.

**Background**

2. On April 24, 2002, the Commission issued a certificate of public convenience and necessity to Northwest to construct and operate dual taps on Northwest's 26-inch and 30-inch mainlines, 48 miles of 20 inch lateral pipeline, a new compressor at Northwest's Turnwater Compressor Station, and a delivery meter station (Grays Harbor Lateral facilities). The Grays Harbor Lateral facilities were built for the purpose of supplying the natural gas requirements of a 650 megawatt electric generating plant planned by Duke Energy Grays Harbor, LLC.<sup>1</sup> Northwest commenced construction on June 4, 2002, and placed the lateral in service on November 1, 2002.

3. The Facilities Reimbursement provisions at section 21.3 of Northwest's tariff require shippers to reimburse Northwest for any receipt or delivery facilities constructed by Northwest either by a (1) lump-sum payment at inception, upon completion of

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<sup>1</sup> On April 16, 2001, Northwest and Duke Energy Grays Harbor, LLC entered into a firm transportation agreement and a facilities agreement relating to the proposed Grays Harbor Lateral. On April 19, 2002, Duke Energy Grays Harbor, LLC assigned the transportation agreement to Duke Energy Trading and Marketing, LLC (DETM).

construction, or (2) a facilities surcharge designed to recover the cost-of-service over the term of service, subject to a shipper's right to terminate such a facilities surcharge at any time by making a lump-sum payment reflecting the then remaining net book value of the facilities. For the Grays Harbor Lateral facilities, Northwest and DETM agreed to the facilities surcharge option under section 21.3(b), and Northwest has billed DETM under this option for the period November 1, 2002, through December 31, 2004.

4. On December 21, 2004, DETM invoked its right to terminate the facilities surcharge pursuant sections 21.3(e) and (f) of Northwest's tariff and requested an invoice for the then remaining net book value, including related income taxes. DETM indicated that it invoked its right to terminate the surcharge because it cancelled its Grays Harbor Generating Plant and there were no alternative uses for the Grays Harbor Lateral constructed by Northwest to serve said plant. Northwest submitted an invoice to DETM reflecting a lump-sum termination payment of approximately \$124 million as of December 31, 2004. DETM disputed Northwest's calculation of the termination payment and claimed it owed Northwest approximately \$93 million. According to Northwest, the lower termination payment calculated by DETM is due to a disagreement over the interpretation of the term "related income taxes" found in section 21.3 of the tariff. Northwest asserts that, in calculating a termination payment, the term contemplates only future tax benefits. DETM, on the other hand, contends that "related income taxes" contemplates both past and future tax benefits. Both parties used the same net book value of approximately \$87 million in their calculations. The termination payment is determined by adding the net book value to the current tax liability and then subtracting the tax benefits of tax depreciation. Under DETM's interpretation, including both past and future tax benefits, would result in a lower current tax liability and a higher tax benefit of tax depreciation resulting in a termination payment reduced by approximately \$31 million from that calculated by Northwest.

5. On January 20, 2005, DETM paid approximately \$93 million to Northwest for the termination payment. Northwest states that since January 2005, it has billed DETM for the \$31 million outstanding balance, plus interest on the unpaid amount. As of June 15, 2005, DETM still had remitted only \$93 million for the termination payment. On June 16, 2005 Northwest filed this petition for declaratory order. Northwest requests that the Commission address the issue arising under its tariff concerning the definition of "related income taxes" by issuing an order declaring that the prospective determination of "future tax benefits resulting from tax depreciation of such facilities," under section 21.3(a) of Northwest's tariff, likewise applies in the determination of "related income taxes" under sections 21.3(e) and (f) of Northwest's tariff.

6. On March 31, 2006, a data request was issued directing Northwest to file certain accounting and tax information so that the Commission Staff could complete the analysis of the issues raised by Northwest and DETM. Northwest filed its data response on April 27, 2006.

### **The Tariff Language at Issue**

7. The tariff language at issue is in the Facilities Reimbursement provisions found in section 21.3 of Northwest's tariff. The pertinent provisions, with emphasis added, are as follows:

21.3 Facilities Reimbursement. All receipt or delivery facilities constructed by Transporter hereunder will be paid for by Shipper as provided below:

(a) Shipper will reimburse in full upon completion of construction for the actual construction costs of facilities constructed by Transporter, and **related income taxes (*i.e.*, the difference between Transporter's current federal and state tax liability resulting from Shipper's reimbursement to Transporter of the actual construction costs of such facilities and the present value of Transporter's future tax benefits resulting from tax depreciation on such facilities, grossed-up for income taxes)**; or

(b) Shipper will reimburse Transporter for the cost of service attributable to subject facilities through a facilities surcharge under a valid transportation service agreement. The terms of reimbursement will be set forth on Exhibit C to the applicable Rate Schedule TF-1, TF-2 or TI-1 service agreement between Transporter and Shipper. Determination of the initial cost of service shall be consistent with the principles underlying Transporter's currently effective transportation rates at the time Transporter and Shipper execute an agreement for the construction of the facilities. Such applicable cost of service will be adjusted prospectively to reflect Commission-approved cost factors, including only operation and maintenance and administrative and general costs actually incurred as a result of the new facilities. Transporter and Shipper may agree on a rate method which provides flexibility regarding method of payment and timing of recovery of the costs of service for the facilities. Shipper may select from the following rate methodologies for the determination of its facilities surcharge:

- (1) volumetric rates;
- (2) monthly cost-of-service charges;
- (3) levelized rate payments; or
- (4) a combination of reservation and volumetric charges

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(e) Shipper may elect at any time to cease paying a facilities surcharge under section 21.3(b) by paying Transporter for the then remaining net book value of the facilities, including any **related income taxes**, at which time the applicable service agreement will be amended to reflect the termination of Exhibit C.

(f) If Shipper elects to reimburse Transporter under section 21.3(b) and subsequently ceases operations at the end-use point or receipt point for which the facilities were installed, or ceases to be a Rate Schedule TF-1, Rate Schedule TF-2 or Rate Schedule TI-1 Shipper (unless its facility cost reimbursement obligations hereunder are assumed by a Replacement Shipper), Shipper will notify Transporter of such occurrence within five business days of such occurrence. Shipper will pay Transporter for then remaining net book value of the facilities, including any **related income taxes**, within 30 days after Transporter submits an invoice to Shipper. Interest calculated in accordance with 18 CFR section 154.501(d) will accrue of any balance remaining after the due date specified on the invoice.

### **Northwest's Petition**

8. Northwest states that, under its tariff, there are two alternatives by which Northwest can agree to be reimbursed for the cost associated with receipt and delivery facilities: (1) under section 21.3(a), a shipper could reimburse, lump-sum, the actual construction costs and "related income taxes," which term is defined as "the difference between [Northwest's] current federal and state tax liability resulting from [DETM's] reimbursement to [Northwest] of the actual construction costs of such facilities and the present value of [Northwest's] future tax benefits resulting from tax depreciation on such facilities, grossed-up for income taxes;" or (2) under section 21.3 (b), a shipper could pay a "facilities surcharge" designed to recover the cost of service over the term of the transportation agreement. Northwest states, as set forth in sections 21.3(e) and (f), having elected to reimburse Northwest via the facilities surcharge under section 21.3(b),

DETM has the right to terminate and cease paying the facilities surcharge by paying Northwest “for the then remaining net book value of the facilities, including any related income taxes.”

9. Northwest asserts that this lump-sum reimbursement of the “then remaining net book value of the facilities, including any related income taxes,” as prescribed in both sections 21.3(e) and (f) for such mid-term reimbursements, must be read in context with the corresponding language in section 21.3(a) prescribing lump-sum reimbursements “for the actual construction costs . . . and related income taxes” at inception, “upon completion of construction.” Thus, Northwest contends, at such point of inception, in accordance with section 21.3(a), DETM would have reimbursed Northwest for its original, undepreciated construction costs, as grossed-up for the income taxes that would have been incurred by Northwest on such a lump sum payment. Northwest states that section 21.3(a) defines the term “related income taxes” to mean “the difference between [Northwest’s] current federal and state tax liability resulting from Shipper’s reimbursement to [Northwest] of the actual construction costs of such facilities and the present value of [Northwest’s] future tax benefits resulting from tax depreciation on such facilities, grossed-up for income taxes.”

10. Northwest states that, correspondingly, a mid-term reimbursement under sections 21.3(e) and (f) contains the same language – “related income taxes,” as earlier introduced and defined in section 21.3(a). Northwest submits, as so defined, “related income taxes” is calculated as the current tax liability resulting from reimbursement of the book value of the facilities less “the present value of [Northwest’s] future tax benefits resulting from such tax depreciation on such facilities.”

11. Northwest states that it reads the identical term “related income taxes” to have a consistent meaning in each of sections 21.3(a), (e) and (f), so as to dictate that only “future tax benefits resulting from tax depreciation on such facilities” be reflected consistently in calculating the gross-up for income taxes. Northwest states that DETM concedes that section 21.3(a) generally describes “related income taxes” to comprehend “future” tax benefits, but contends that section 21.3(a) deals with reimbursement at the time the facilities are placed in service, at which point in time, according to DETM, the only tax benefits associated with depreciation are “future” tax benefits.

12. Northwest asserts that the Commission has already addressed the treatment of post-inception, mid-term reimbursements and has found that “future” tax benefits apply in that context. Northwest states that in *Northwest Pipeline Corporation*, 87 FERC ¶ 61,227 (1999) (hereinafter referred to as *Columbia Gorge*), involving a certificate issued to Northwest for additional capacity to serve DETM on Northwest’s mainline system in the Columbia Gorge to Sumas corridor, the Commission observed that, where service agreements are terminated before facilities are amortized fully, shippers are

required to reimburse Northwest for the net book value and any associated taxes “defined as the difference between Northwest’s current tax liability as the result of the reimbursement and the present value of Northwest’s future tax benefits resulting from tax depreciation of the Columbia Gorge facilities.” *Id.* at 61,915, n. 8. Northwest contends that the tariff’s future, forward-looking prescription for the treatment of tax benefits in the calculation of reimbursement-related income taxes applies to all such reimbursements, both at inception and mid-term.

13. Accordingly, Northwest requests that the Commission terminate this controversy by issuing a declaratory order confirming that only “future tax benefits” are contemplated by the term “related income taxes” in each and every instance that it appears in the subject tariff provisions.

### **Public Notice, Interventions and Protests**

14. Public notice of Northwest’s petition was issued on June 22, 2005, providing for interventions and protests to be filed on or before July 15, 2005. A motion to intervene and answer was filed by DETM on July 15, 2005.

15. DETM states that the crux of the controversy at issue is the meaning of the words “related income taxes” as they are used in section 21.3(e). DETM states that the parties disagree on whether the computation of the lump sum payment due under the tariff should take account of all the depreciation deductions from which Northwest has benefited, and will benefit, with respect to the Grays Harbor Lateral, or only the future depreciation deductions from which Northwest will benefit. DETM states that the parties also disagree as to whether “related income taxes” in this case should take account of the impact of the lump sum payment on Northwest’s deferred tax liability.

16. DETM asserts that “related income taxes” is not a defined term under Northwest’s tariff. DETM asserts that if it were a defined term, it would be capitalized, it would be listed in section 1 with the other defined terms in Northwest’s tariff, and it would have the same meaning each place it appears in the Northwest tariff. DETM contends that, like all other uncapitalized words in the Northwest tariff, the meaning of the words “related income taxes” must be determined by their context, and by the purpose of the provision in which they were included. DETM asserts that limiting the term “related income taxes” to future tax benefits resulting from tax depreciation on the subject facilities in the context of section 21.3(a) is reasonable because in cases where reimbursement is made at the time the facilities are placed in service, the only tax benefits associated with depreciation deductions are future benefits. In contrast, DETM asserts that section 21.3(e) deals with a reimbursement that occurs after the facilities have been placed in service. DETM submits that, in this case, some of the tax benefits associated with the depreciation of the facilities have already been obtained by

Northwest, and some of the tax benefits will not be realized until a future date. In addition, DETM contends that facilities that have been the subject of a facilities surcharge will also likely have an accumulated deferred income tax (ADIT) associated with it.

17. DETM asserts that Northwest's reliance on the *Columbia Gorge* case to support its interpretation of section 21.3(e) is misplaced. DETM asserts that the *Columbia Gorge* case did not involve reimbursement for lateral line facilities under section 21 of the Northwest tariff. DETM submits that case involved a mainline expansion and the payment in that case was governed by section 3.4 of Rate Schedule TF-1. DETM contends that Northwest's reliance on the *Columbia Gorge* order is also misplaced in that Northwest asserts that the Commission "found" that only future tax benefits from depreciation should be taken into account in determining a reimbursement payment. DETM argues that, in fact, the Commission's mention of future tax benefits in the *Columbia Gorge* order was not a finding as to which computation methodology should be used; rather, it was a recitation of the terms of the facilities reimbursement agreement that the parties had entered into in connection with that project.

18. DETM contends that the Commission has previously stated that the purpose of section 21 of Northwest's tariff is to compensate Northwest for the construction of lateral line facilities, but that Northwest should not receive a windfall as a result of a lump sum reimbursement under section 21.<sup>2</sup> DETM argues that, in order to prevent a windfall to Northwest, the computation of the lump sum payment due under section 21.3(e) must take into account the fact that Northwest has received tax benefits from prior years' depreciation deductions, and the fact that Northwest has an accumulated deferred income tax (ADIT) balance associated with the facilities surcharge that, as a result of the lump sum payment, will never be required to pay future income taxes on the facilities surcharge. DETM asserts that the practical effect of the methodological differences between Northwest and DETM is heightened by the Job Creation and Worker Assistance Act of 2002 (Job Creation Act). DETM states that the Job Creation Act provided for 30 percent bonus tax depreciation for certain facilities placed into service following the September 11, 2001 terrorist attacks. DETM states that the Grays Harbor Lateral was placed into service on November 1, 2002, and was therefore eligible for bonus depreciation under the Job Creation Act. DETM submits that under Northwest's interpretation the \$27.7 million in depreciation associated with the Grays Harbor Lateral facilities for the 2002 tax year would not be reflected in the computation to determine DETM's lump sum payment.

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<sup>2</sup> Citing, *Northwest Pipeline Corporation*, 96 FERC ¶ 61,128 (2001).

19. DETM argues that, in order to avoid a windfall to Northwest from the termination of the facilities surcharge, the computation of the lump sum reimbursement payment must reflect the tax benefits from all depreciation deductions associated with the Grays Harbor Lateral – both past and future, and must also reflect ADIT balances collected by Northwest through the facilities surcharge.<sup>3</sup>

### **Discussion**

20. In its petition, Northwest requests that the Commission terminate the controversy concerning the facilities reimbursement provision in section 21.3 of its tariff by issuing a declaratory order confirming that only “future tax benefits” are contemplated by the term “related income taxes” in each and every instance that it appears in the subject tariff provisions.

21. Based upon a review of the pleadings in this proceeding, and the supplemental tax and accounting information filed by Northwest pursuant to the data request, the Commission finds that this proceeding cannot be resolved simply by answering the narrow question posed by Northwest in its petition. The Commission finds that determining that only “future tax benefits” are contemplated by the term “related income taxes,” as requested by Northwest, would not achieve an appropriate result. Similarly, the interpretation advocated by DETM, including both future and past tax benefits in determining “related income taxes,” also will not achieve an appropriate result.

22. The Commission finds that that neither Northwest nor DETM have properly determined the facilities reimbursement amount. The termination payment, if properly determined, should leave Northwest with enough cash to recoup its remaining capital investment in the Grays Harbor facility, after taking into consideration the payment of taxes on the termination payment and net present value of the future tax benefits on the remaining tax basis existing at the time of the buyout. Under this premise, Northwest’s termination billing of \$124,422,232 will allow it to collect more from DETM than needed

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<sup>3</sup> In its answer, DETM also requests that the Commission rule (1) that DETM is entitled to receive a refund of the portion of the facilities surcharges it has paid under the Transportation Agreement, and of its lump sum payment made to Northwest in January of 2005, under the circumstances of section 21.4 of the Northwest tariff in the event that the Grays Harbor Lateral facilities are utilized to serve other Northwest customers and (2) that Northwest must offer to DETM an ownership interest in the Grays Harbor Lateral proportional to DETM’s lump sum payment to Northwest. The Commission will not address these issues because DETM is seeking affirmative relief that is neither ripe nor within the scope of the question presented by the declaratory order.



to recover its capital investment and related income taxes on the Grays Harbor facility. On the other hand, the \$93,962,131 DETM asserts is the correct amount of the termination payment will lead to an under-recovery of Northwest's capital investment and related income taxes on the Grays Harbor facility.

23. Northwest contends that DETM's calculation is improper because it results in a normalization violation. Northwest asserts that any return of the benefits of accelerated tax depreciation claimed in years 2003 and 2004 to DETM may result in a violation of the normalization provisions of section 168 of the Internal Revenue Code (IRC) resulting in the denial of accelerated depreciation to Northwest. Northwest further asserts that there is no basis in the IRC for returning benefits to DETM.

24. Northwest's arguments concerning a possible normalization violation are misplaced, as no tax benefits are being returned to DETM by taking into consideration the deferred taxes in Northwest's ADIT accounts on the date of the termination of the facilities reimbursement payment. Rather, the existing ADIT balance is properly used as a reduction in the calculation of the termination payment to reflect the fact that a taxable event occurred as a result of the contract termination and the existing deferred taxes in the ADIT balances are to be used to pay the government the tax due on the termination proceeds. As the Commission found in *Enbridge Pipelines*, the deferred taxes in the ADIT balances are intended to be paid to the government as taxes when the taxes become due.<sup>4</sup> Failure to include the existing ADIT balances in the calculation of the termination payment will result in a windfall to Northwest.

25. The Commission agrees with the general approach used by DETM in determining the termination payment. However, certain calculations must be revised to properly compensate Northwest for the contract termination. Specifically, DETM's calculation must be revised to eliminate the compound interest computed on Northwest's past tax depreciation deductions. The compound interest factor on Northwest's past tax depreciation deductions must be eliminated because these amounts were deducted in deriving net rate base in the prior cost-of-service charges that DETM paid, so DETM has already received the time value of these deductions. Additionally, DETM's calculation must be revised to reflect the actual remaining depreciable tax lives of the assets in its present value calculation. DETM based its present value calculation on the use of an estimated 15-year tax life that it believed the assets had, while Northwest points out that some of the assets have a 22-year depreciation life for tax purposes.

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<sup>4</sup>*Enbridge Pipelines*, 102 FERC ¶ 61,310 at P 68 (2003).

The Commission orders:

Northwest's June 16, 2005 petition for declaratory order is granted in part and denied in part consistent with the discussion in the body of this order.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.